



The Real Estate Roundtable

**STATEMENT OF  
JEFFREY D. DEBOER  
ON BEHALF OF  
THE REAL ESTATE ROUNDTABLE**

**UNITED STATES HOUSE OF REPRESENTATIVES  
SUBCOMMITTEE ON SELECT REVENUE MEASURES  
OF THE  
COMMITTEE ON WAYS AND MEANS**

**HEARING  
ON  
TAX REFORM AND FOREIGN INVESTMENT  
IN THE UNITED STATES**

**LONGWORTH HOUSE OFFICE BUILDING  
ROOM 1100  
WASHINGTON, DC**

**THURSDAY, JUNE 23, 2011**



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**INTRODUCTION**

Chairman Tiberi and Members of the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, the Real Estate Roundtable is pleased to submit this statement for the record of the hearing on June 23, 2011 regarding the importance of foreign direct investment to the U.S. economy, and how tax reform might affect foreign-headquartered businesses that invest and create jobs in the United States. The Roundtable represents the leadership of the nation's top privately owned and publicly held real estate ownership, development, lending and management firms, as well as the elected leaders of the 17 major national real estate industry trade associations. Collectively, Roundtable members hold portfolios containing over 5 billion square feet of developed property valued at over \$1 trillion; over 1.5 million apartment units; and in excess of 1.3 million hotel rooms. Participating Roundtable trade associations represent more than 1.5 million people involved in virtually every aspect of the real estate business. More information on The Roundtable can be found at [www.rer.org](http://www.rer.org).

This statement will address the acute need for increased foreign investment in U.S. real estate, and the critical role that tax reform plays in encouraging this investment. The Roundtable couldn't agree more with President Obama's June 20<sup>th</sup> statement that, "[i]nvestments by foreign-domiciled companies and investors create well-paid jobs, contribute to economic growth, boost productivity, and support American communities." The U.S. tax system plays a critical role in either encouraging or deterring this investment. The Roundtable applauds the Subcommittee for recognizing this fact, and for considering proposals for simple changes to our tax code that can make investment in the U.S. more attractive to foreign investors, which in turn will create jobs in the U.S.

## I. SUMMARY AND ECONOMIC BACKGROUND

### A. Summary of Current Conditions

- **The commercial real estate market is in dire need of new equity investment in order to preserve and create jobs.** The commercial real estate market in the U.S. is still reeling from the economic turmoil and precipitous drop in real property values of the past few years. A significant number of jobs in the industry (and associated with the industry) have been lost, and many remain at risk. An infusion of equity capital is sorely needed in order to bridge the financing gap faced by many properties, facilitate redevelopment and new construction, and restore jobs to the industry.
- **FIRPTA acts as a significant deterrent to foreign equity investment in U.S. real property.** The Foreign Investment in Real Property Tax Act ("FIRPTA") presents an onerous tax and administrative burden to foreign investors in U.S. real property companies, a burden not borne by foreign investors in any other U.S. asset class.
- **Uncertainty as to the application of section 864 inhibits foreign investment in U.S. debt.** Current uncertainty as to when an investment in U.S. debt will be treated as a U.S. trade or business of the foreign investor discourages foreign acquisitions of U.S. debt, thereby exacerbating the constrained credit markets faced by U.S. real property owners.

### B. Recommendations

- **FIRPTA should be repealed in its entirety.** FIRPTA has succeeded beyond its enactors wildest dreams in discouraging foreign investment in U.S. real property. It is a deterrent to foreign investors, an administrative drain on U.S. corporations and their foreign investors, and without policy justification. If budgetary constraints were not a factor, the Roundtable would recommend that FIRPTA be repealed in its entirety now.
- **Measured, cost-effective FIRPTA reform will encourage increased investment in U.S. real property.** By expanding the FIRPTA exception currently applicable to 5 percent shareholders in publicly-traded real estate investment trusts ("REITs") to 10 percent shareholders, foreign investors will be able to significantly increase investment in U.S. real property. In addition, clarifying that REIT liquidating distributions are treated as sales of stock will

relieve the current uncertainty as to the U.S. tax treatment of these distributions, and encourage greater foreign investment in the U.S. commercial real estate market, particularly in smaller real estate markets.

- **Potential foreign investors in U.S. debt need the U.S. Treasury Department and Internal Revenue Service to issue guidance regarding what constitutes a “U.S. trade or business.”** Foreign investors in U.S. debt securities currently face significant uncertainty as to how to structure their debt investments without being treated as engaged in a U.S. trade or business. The Treasury Department and the IRS have been repeatedly petitioned to issue guidance, but have yet to do so. Providing guidelines for foreign investors would attract significant foreign investment into U.S. debt, providing some relief for U.S. borrowers in the current tight credit markets.
- **No position being advocated in this statement will alter the current review process in place for foreign investment in our nation’s critical infrastructure.** The tax reform measures we are proposing will in no way affect alter or weaken the laws governing foreign investment in critical infrastructure within the U.S.
- **Now is the time to act.** The commercial real estate market is under stress now. The people dependent on jobs in this market need work now. Now is the time to take affirmative action and induce greater foreign investment into the U.S. commercial real estate market. As summarized in a report by The Rosen Consulting Group, reforming FIRPTA would “unlock billions of dollars in investible capital into the commercial real estate market.”<sup>1</sup> This infusion of equity would provide the capital needed to finance maintenance, upgrades and new developments – and employ the thousands of people working in this industry.

### C. Economic Background

The U.S. commercial real estate market, plummeted into crisis by the economic upheaval of the past few years, remains vulnerable to further economic stress. While many of the large “gateway” markets are beginning to recover, the remainder of the commercial real estate markets continue to be deeply troubled, contributing to the chronic unemployment in the country, as jobs relating to commercial real estate have been lost and have not returned. Property values have declined over the past three years (approximately 30-50% from 2007 peak to trough), such that some estimate that approximately half of all commercial mortgages are thought to be underwater, while nearly \$1.5 trillion in commercial real estate loans will come due in the next four years. As outstanding loans mature, property owners will have difficulty refinancing in the current tight credit markets, particularly in light of decreased property values, forcing many properties into default. The sustained financial pressure on property owners and lack of credit availability has led to deferral of maintenance and upgrades on existing properties, while development of new projects has trickled to a standstill, all resulting in a significant loss of jobs.

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<sup>1</sup> Rosen, Kenneth T. et al., “*FIRPTA Reform: Key to Reviving Commercial Real Estate*,” Rosen Consulting Group, March 2010.

The potential for commercial real estate defaults to derail a fragile economic recovery, particularly in non-gateway markets, and lead to even further job losses, bank closures and business retraction is very real. The need to address the issue is imperative. The real estate community is in agreement that increased equity investment will be a crucial measure in preventing foreclosures, by providing real estate owners with the capital necessary to bridge the gap between financing available and maturing debt. There is consensus that a tremendous amount of potential equity investment capital is in the hands of foreign investors. This significant source of equity capital is needed in the U.S. now.

Preventing a wave of defaults in the commercial real estate market is intrinsically linked to preserving jobs and the general economic health of communities. The Congressional Oversight Panel's February 2010 report "Commercial Real Estate Losses and the Risk to Financial Stability" emphasized the link between the crisis in commercial real estate and the risk to greater job losses, stating:

Approximately nine million jobs are generated or supported by commercial real estate including jobs in construction, architecture, interior design, engineering, building maintenance and security, landscaping, cleaning services, management, leasing, investment and mortgage lending, and accounting and legal services. Projects that are being stalled or cancelled and properties with vacancy issues are leading to layoffs...The fewer loans that are available for businesses, particularly small businesses, will hamper employment growth...

The report makes clear that commercial property failures lead to a "downward spiral" of economic ramifications, particularly job losses. Measures to bolster the commercial real estate market will have a direct impact on the various employment sectors linked to commercial real estate. Increased equity investment in commercial real estate will provide real property owners with much needed capital to successfully refinance maturing loans and engage in new projects and improvements to existing properties. In sum, providing commercial property owners with this much needed capital would benefit local communities by:

- Preserving jobs tied to commercial real property as property owners are able to refinance loans and maintain ownership of properties
- Bolstering demand for employment in the construction and business maintenance fields as property owners perform delayed upkeep and upgrades
- As concerns regarding possible commercial mortgage defaults are reduced, banks will have greater breathing room to provide small businesses with access to credit, expand their businesses and make new hires

Commercial real estate is intricately connected with the fate of our economic recovery, both locally and nationally. Encouraging greater foreign investment into the real estate market will stimulate job creation and preservation in a critical sector of our economy.

## **II. CURRENT TAX RULES DISCOURAGE FOREIGN INVESTMENT IN U.S. REAL PROPERTY**

### **A. Taxation under FIRPTA**

FIRPTA is a discriminatory tax regime. It is applicable only to investors in U.S. real property. It imposes a higher tax cost on gains from real property, even gains from passive investments, than that imposed on gains from any other type of U.S. asset.

FIRPTA treats any gain or loss realized by a foreign investor in a “U.S. real property interest” as though the gain or loss were effectively connected to a U.S. trade or business, and taxes such gain or loss in the same manner as a U.S. resident would be taxed. The term “U.S. real property interest” includes real property located in the United States as well as interests in any “U.S. real property holding corporation.” A “U.S. real property holding corporation” is generally any corporation whose investments in U.S. real property interests equal or exceed 50 percent of the fair market value of the corporation's assets. In summary, under FIRPTA, foreign investors are subject to U.S. tax on the disposition of shares in a U.S. corporation holding U.S. real property, as well as gains realized from direct investments in U.S. real estate.

Foreign investors in no other type of U.S. corporation are subject to U.S. tax on a sale of that corporation's stock. In fact, foreign investors are subject to U.S. tax on capital gains only where those gain relate to real property, effectively punishing foreigners for investing in U.S. real estate, rather than, for example, a U.S. pharmaceutical company. It is unclear what purpose this serves, other than exacerbating the economic distress of a struggling industry.

The taxing regime established by FIRPTA is enforced through complex withholding and reporting obligations. Any transferee of a U.S. real property interest from a foreign transferor is generally required to withhold 10 percent of the transferor's amount realized on the sale. In order to administer this obligation, every U.S. corporation is required to establish whether or not it is a U.S. real property holding corporation. FIRPTA thus presents an administrative burden to U.S. corporations, as well as a financial burden to their foreign investors.

In addition, FIRPTA presents formidable barriers even beyond the FIRPTA taxes themselves. Any investor that is caught in the FIRPTA trap must file a tax return with the IRS, which is not required for any other stock investment and which by itself turns away a substantial number of non-U.S. investors. Compounding these barriers is that FIRPTA also subjects the non-U.S. investor to state and local tax return and tax obligations (again, unique for investors in equity stocks) and in many situations activates the "branch profits" tax, thus triggering an effective federal tax rate as high as 54 percent on these equity investments.

### **B. The application of FIRPTA to interests in corporations discourages investment in U.S. real property**

Foreign investors in U.S. real property typically invest in such property through a U.S. corporation. By taxing gain realized on *stock* in U.S. corporations holding U.S. real property, FIRPTA creates a false dichotomy between investments in U.S. corporations holding U.S. real property and corporations engaged in any other type of activity. As noted above, foreign investors in U.S. corporations are not subject to capital gains tax upon the disposition of stock *except* where that company holds the requisite percentage of U.S. real property. Moreover, due to the complexity and in many cases uncertainty of determining whether the specified percentage

is achieved, many U.S. corporations cannot determine with confidence whether FIRPTA applies to ownership of their shares, leading to confusing public disclosure, inefficiency and wasted resources, and inadvertent noncompliance. U.S. corporations in a variety of fields, from hotel chains to oil and gas companies, as well as other real estate companies, are therefore less attractive investments to foreign purchasers than, for example, U.S. computer software companies. This limits the universe of potential foreign buyers of, or investors in, U.S. corporations with a real property-based business.

In the absence of reform, potential foreign investors in U.S. corporations holding U.S. real estate may, in light of the application of FIRPTA to their eventual disposition of such interests, continue to invest elsewhere – either in real property in countries with less onerous tax regimes, or in other types of U.S. corporations. This preference for other U.S. assets is evidenced by the percentage of certain types of U.S. assets held by foreign investors – 49 percent of U.S. government securities and 16 percent of corporate stocks are held by foreign investors, while only 5 percent of commercial real estate is held by foreign investors.

As stated above, and will be stated again, the U.S. commercial real property market needs an infusion of equity at this time, not a tax regime that deters foreign investment.

### **C. FIRPTA leads to an inefficient allocation of resources**

FIRPTA leads to inefficient allocations of capital by foreign owners of U.S. real property. Given the tax burden faced upon disposition of such property, foreign holders of U.S. real property may be overly influenced by U.S. tax considerations when deciding when to sell their U.S. real property interests or how long to hold them. Capital that might be more effectively put to use via other investment opportunities thus remains locked in U.S. real properties. Moreover, U.S. real properties that might be put to a more productive use in the hands of other owners are unavailable to prospective buyers.

In addition, FIRPTA is a highly complex provision, with internal inconsistencies that can lead to very different tax results from minor differences in transactions. Foreign companies allocate excessive amounts of time and resources to intricate tax-planning and restructuring, rather than productive business activity, in order to avoid tripping FIRPTA. Companies that spend such significant amounts of time and money on FIRPTA planning generally can plan around FIRPTA. In this way, FIRPTA has been reduced to a trap for the unwary – only the unsophisticated or poorly advised end up paying FIRPTA taxes, although significant sums are spent in avoiding it.

### **D. Inequalities in the Code addressed by the U.S. real property holding corporation provisions of FIRPTA no longer exist**

The legislative discussion surrounding the enactment of FIRPTA focused on the perceived need to prevent foreign investors from enjoying a tax advantage over U.S. investors when investing in U.S. real property. Specifically, the legislative history considered transactions in which a foreign investor could enjoy net basis taxation on income from an interest in U.S. real property, and then avoid capital gains upon the property's disposition. Prior to 1986, a U.S. corporation holding U.S. real property could sell the property and liquidate within a year of the sale. Under old section 337, the corporation would not recognize gain on the transaction (the "General Utilities doctrine"). Shareholders recognized capital gain on the liquidating distribution,

but this gain was considered to be with respect to their stock. A foreign investor would not be subject to tax on capital gain arising from disposition of the stock, so the gain in the underlying real property sold prior to the liquidation escaped the U.S. tax system altogether. This concern motivated Congress to tax gain on the sale of shares in U.S. corporations holding U.S. real property and to disregard the Treasury statement advising *against* the implementation of such a tax.

Subsequent to FIRPTA's enactment, however, old section 337 was repealed. Under current law, a corporation is required to recognize gain on the sale or distribution of property upon liquidation as though it had sold the distributed property for fair market value, thereby ensuring that U.S. tax is imposed on the gain inherent in the underlying real property. In other words, as a result of the repeal of the General Utilities doctrine, any gain from a liquidation is taxed twice: once to the liquidating firm and again to the stockholder. Thus, with the repeal of the General Utilities doctrine, the primary tax policy concern justifying U.S. taxation of gain on the disposition of an interest in a U.S. real property holding corporation is no longer relevant.

## **E. Summary**

FIRPTA is an anomaly in the pattern of U.S. taxation of foreign investors; with a few technical exceptions, FIRPTA is literally the only major provision of the U.S. tax code which subjects foreign investors to taxation on capital gains realized from investment in U.S. assets. As described above, FIRPTA acts a significant deterrent to investment in U.S. real property corporations, the costs of compliance are prohibitive, and the policy justifications behind FIRPTA's enactment are no longer relevant. In sum, FIRPTA is an idea whose time has come and gone, and, were it fiscally feasible, should be abandoned in its entirety.

The Roundtable recognizes, however, that budgetary constraints may make it difficult to repeal FIRPTA at this time. Reasonable, cost-efficient reform is still possible, and the Roundtable strongly urges steps be taken to address the negative effects of FIRPTA and ameliorate the current pressure on the U.S. commercial real estate market.

## **III. REASONABLE STEPS MAY BE TAKEN TO INCREASE FOREIGN INVESTMENT IN U.S. REAL PROPERTY**

The Roundtable wholeheartedly supported the FIRPTA reform measures proposed in H.R. 5901, the Real Estate Jobs and Investment Act of 2010, which passed in the House of Representatives last July by a vote of 402-11, and currently supports proposed legislation being promoted by Congressmen Kevin Brady (R-TX) and Joe Crowley (D-NY). The Brady/Crowley legislation proposes cost-efficient FIRPTA reform that will encourage foreign investors to significantly increase their ownership of U.S. real property through REITs by expanding certain limited exceptions to the application of FIRPTA, and by providing clarity regarding the U.S. tax treatment of REIT liquidating distributions.

### **A. Expand the 5% Shareholder Exception to 10% Shareholders in a REIT**

Presently, a foreign shareholder owning five percent or less of a publicly-traded U.S. real property company, including a REIT, is exempt from FIRPTA on a sale of the corporation's stock. In addition, a foreign shareholder owning 5 percent or less of a publicly-traded REIT is exempt from FIRPTA on the receipt of a capital gain distribution attributable to the sale or



exchange of a U.S. real property interest. Such a foreign shareholder treats all dividends from the REIT as ordinary dividends. If a REIT dividend to a foreign shareholder is treated as ordinary pursuant to the 5 percent shareholder exception, the U.S. tax rate applicable to the dividend is determined with reference to the U.S. tax treaty relevant to the foreign shareholder. Under many U.S. tax treaties, if a foreign shareholder in a REIT owns 10 percent or less of the REIT, the foreign shareholder is eligible for a reduced treaty rate, typically 15 percent, on REIT ordinary dividends.

Increasing the FIRPTA small shareholder exception from 5 percent to 10 percent shareholders in REITs would attract significant new investment into the U.S. Many overseas investors considering global real estate investments currently limit their investments in the U.S. to remain within the 5 percent FIRPTA limitation. For example, there are billions of dollars invested in funds benchmarked to global real estate indexes for which the U.S. represents roughly a third of the total global index. Many of these funds refrain from investing more than 5 percent in any REIT and losing the benefit of the exception, and thus are underweighted in the U.S. with less than one third of their capital invested in U.S. real estate. Increasing the 5 percent exception to 10 percent would allow these funds to shift their global real estate allocation and directly increase their exposure to U.S. publicly-traded REITs.

Under a few U.S. tax treaties, foreign investors investing in U.S. REITs through certain widely-held, publicly-listed, treaty-recognized mutual fund-type investment vehicles are also eligible for the 15 percent reduced treaty rate on REIT distributions. To be consistent with U.S. tax treaties, the proposed reform clarifies that the exemption applies to foreign investors investing in U.S. REITs through such treaty-recognized mutual fund-type investment vehicles. These investment vehicles are similar to our mutual funds - they are widely held by small foreign investors and provide a means for such investors to invest in U.S. REITs through a familiar, local entity. The U.S. tax treaties look through these vehicles because, as the U.S. Treasury Technical Explanation discussing one such provision states, *“the tax benefits [of investing in an investment vehicle] are intended to replicate the tax treatment of direct investment by these unitholders.”* To ensure equal treatment with investors investing directly in a U.S. REIT, a foreign investor investing in a U.S. REIT through a mutual fund-type investment vehicle would only be eligible for the FIRPTA exemption if the foreign investor owned 10% or less of the REIT. If a foreign shareholder owned more than 10% of a U.S. REIT (either directly or through a mutual fund-type investment vehicle), the investor would be subject to full FIRPTA withholding on REIT distributions and on sales of the REIT stock.

## **B. Clarify that REIT Redemptions and Liquidating Distributions are Sales of Stock**

IRS Notice 2007-55 (the “Notice”) presents another obstacle to foreign investment in U.S. commercial real property, and should be repealed.

The IRS asserted in the Notice that REIT liquidating distributions to foreign shareholders should be treated, to the extent attributable to gain with respect to U.S. real property, as capital gain distributions subject to FIRPTA. The Internal Revenue Code specifically states that amounts received by a shareholder in a distribution in complete liquidation of a corporation “shall” be treated as in full payment in exchange for the stock. Until the issuance of the Notice, there was no reason for foreign investors to believe that liquidating distributions by REITs, as with the liquidating distributions of any other corporation, should be treated as anything other than as sales of stock. Needless to say, the IRS’ position has caused considerable consternation

in the foreign investor community and has severely constrained continued foreign investment in U.S. real estate.

The Notice also creates distinctions in tax treatment between REIT shareholders in economically parallel positions. For example, a REIT's liquidating distributions to its domestic shareholders are treated as sales of stock, while those to its foreign shareholders are treated as sales of assets (and hence subject to FIRPTA). Nothing in section 897 authorizes the IRS to recharacterize a sales transaction in order to achieve a different tax result for foreign investors. This dichotomy of tax treatment both discourages foreign investment in the U.S. and is without policy justification, as liquidating distributions are the economic equivalent of a shareholder selling all of its stock in the REIT. The Tax Section of the American Bar Association in a June 2008 report concluded that the Notice is insupportable and found little legislative basis for the position taken in the Notice. The report concludes that the Notice should be repealed and that, consistent with the treatment of a U.S. shareholder, "a foreign shareholder's gain on a deemed sale of REIT shares pursuant to a liquidation or redemption ought to be taxed under the FIRPTA rules that apply to stock sales."

There is nothing abusive behind the repeal of the Notice – investors in a domestically-controlled REIT can currently sell their REIT stock prior to a liquidating distribution and avoid FIRPTA. Likewise, sovereign wealth funds can avoid U.S. tax on their REIT investments by limiting their investments in U.S. REITs to a minority position and then selling their investments prior to the REIT making a liquidating distribution. The Notice simply creates an arbitrary distinction in the U.S. tax treatment of a foreign investor depending on whether the foreign investor exits its REIT investment immediately prior to the REIT's liquidation or pursuant to the REIT's liquidation.

With the Notice outstanding, foreign investors are now uncertain regarding the potential U.S. tax burden that may be imposed on gains from investments in U.S. real estate. They are therefore hesitant to invest more equity in U.S. real estate, particularly in non-gateway markets where the anticipated return from investments lies in appreciation of the property rather than operating cash flows. Repeal of the Notice would thus help the neediest markets most – foreign investors would return to REITs investing in smaller market properties, armed with greater clarity as to the U.S. tax treatment of the anticipated capital gains from their investment.

The proposed reform clarifies that the historic understanding of the treatment of REIT liquidating distributions as sales of stock remains unaltered. By overturning Notice 2007-55, the U.S. government would be viewed by foreign investors and sovereign wealth funds as promoting tax policies that are efficient and effective in integrating the corporate and individual tax regimes with respect to real estate investment, allowing a broader class of investors to invest in real estate, giving real estate principals greater access to capital, promoting both capital export and import neutrality, and expanding the push toward territorial taxation in a controlled fashion to include passive-type investment in real estate.

#### **IV. PROVISION OF GUIDANCE REGARDING THE APPLICATION OF SECTION 864(b) WILL ENCOURAGE GREATER LENDING INTO THE U.S.**

The Roundtable also urges the Subcommittee to direct the U.S. Treasury Department and Internal Revenue Service to issue guidance to foreign investors with respect to lending activities into the U.S.

The application of U.S. federal income tax to foreign investors generally depends on whether the investor is engaged in the conduct of a trade or business within the United States. If the investor is not so engaged, U.S. tax generally is imposed only on certain enumerated categories of U.S. source income (e.g., dividends on U.S. stock, certain categories of interest income, and capital gains on certain forms of equity investment in U.S. real estate). In contrast, if the investor is engaged in the conduct of a trade or business within the United States, the U.S. imposes a regular income tax on that portion of the investor's worldwide income that is "effectively connected" with that trade or business.

The Code, however, does not contain a comprehensive definition of the term "trade or business." While loan origination is understood to constitute a trade or business, many foreign investors struggle to structure their investments in U.S. debt so as to avoid being treated as having originated a loan, even where they are clearly acting as passive investors. Investors seek to satisfy the safe harbors provided in section 864(b) of the Code for proprietary trading by non-dealers in stocks, securities and commodities, and thereby avoid being treated as engaged in a trade or business, but there is significant uncertainty as to how exactly to qualify for the safe harbors.

For example, in an effort to fit within the safe harbors, many foreign investors seeking to invest in U.S. debt arrange to acquire U.S. debt from a U.S. bank only after forty-eight hours have passed from the time the U.S. bank has originated the loan. Some foreign investors also believe that the commitment to acquire the loan must be conditional so as to avoid treatment of the U.S. bank as an agent of the foreign investor. Yet the conditionality required to give the investor comfort for tax purposes may not be commercially viable, leaving foreign investors in a quandary, seeking to balance the effort to invest in U.S. debt with the uncertainty as to whether that investment will cause the investor to be treated as engaged in a U.S. trade or business. Moreover, this position has never been sanctioned by the IRS. The absurdity of the situation is made more apparent when compared to the relative lack of complication foreign investors face when investing in publicly-issued debt in the U.S., which most foreign investors are comfortable acquiring at the original issuance. Both forms of investment are passive investments in debt of a U.S. borrower for the foreign investor, and should not require different structuring machinations.

In addition, foreign investors are limited in their ability to buy U.S. distressed debt; for fear that a subsequent restructuring of that debt will render their participation in the restructuring equivalent to a U.S. trade or business. With the excessive amounts of distressed debt circulating in the credit system at present, providing guidance to potential foreign investors in that debt should be a top priority of the of the Treasury Department and the IRS.

The provision of "guidance on lending activities under section 864" has been on the IRS-Treasury business plan since August 2006. The IRS has been repeatedly petitioned to provide guidance, but none has been forthcoming. As a result, foreign investors with substantial capital that could be made available to ease the credit shortage in the U.S. are currently unwilling to do so, in large measure because of the tax uncertainty created by the continuing absence of definitive guidance as to the scope of the safe harbor for proprietary trading in securities. In these circumstances, counsel to foreign investment funds have frequently concluded that many of the types of transactions that are now prevalent in the U.S. credit markets simply involve too much tax uncertainty, particularly as many foreign investment funds represent to their own investors that they will not engage in activities that would be treated as a trade or business and expose them to U.S. taxation on a net income basis. As a result, transactions that would add significant

liquidity to the U.S. credit markets and provide long-term benefits to the U.S. economy – purchasing loans on the secondary market and, where applicable, participating in restructuring of those loans and other securities – are not being undertaken.

In light of the ongoing constraints on the availability of credit in the U.S., and changes in the lending-related practices of banks and other loan originators, the Roundtable urges the members of the Subcommittee to direct the Treasury Department and the IRS to issue guidance as soon as possible setting forth a series of safe harbors that would reflect current practices in the U.S. credit markets and permit foreign investors to invest in U.S. debt with confidence as to the U.S. tax results of that investment.

## **CONCLUSION**

In conclusion, the commercial real estate market in the U.S. faces unprecedented challenges. There are tools available, however, to assist the market in recovering from the difficulties of the past few years. Taking simple steps to encourage greater investment in U.S. real property and U.S. debt securities will provide the investments needed by the commercial real estate market to avoid foreclosures, maintain and upgrade existing properties, develop new real estate projects and employ the thousands of people dependent on this vital sector of our economy. Now is the time for action. Now is the time to enact simple changes that will make a dramatic difference in the U.S. commercial real estate market.